

## Internal Revenue Service

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Washington, DC 20224

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December 02, 2010

### Legend:

Parent =

Company =

State A =

Business A =

Sub 1 =

Sub 2 =

Shareholder A =

Date A	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
i	=
j	=

Dear

This letter responds to your July 16, 2010 request for rulings on certain federal income tax consequences of the Proposed Conversion described below. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

### **SUMMARY OF FACTS**

Parent, a State A stock insurance holding company, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar-year basis. Parent wholly owns Company, a State A stock insurance company that is engaged in Business A. Parent also wholly owns two other State A companies (Sub 1 and Sub 2) that are engaged in business ancillary to Company's insurance

business. Each of Company, Sub 1, and Sub 2 is a member of Parent's consolidated group (the "Parent Group").

At the time of Parent's formation, State A law did not permit the creation of mutual insurance holding companies. Since a mutual holding company structure was preferable to the Parent Group from a business perspective, the terms of Parent's capital structure were designed to mirror those of a mutual insurance holding company.

Parent has two classes of stock outstanding: Class B and Class C. Shareholder A holds the one outstanding share of Class B stock, which confers the right to elect Parent's board of directors. This share otherwise confers no rights, and it may be redeemed for \$a upon a vote of holders of the Class C shares (the "Class C Shareholders"). The Class B share will be redeemed and cancelled prior to the proposed transaction.

The Class C Shareholders are physicians who are directly insured by Company or who are indirectly insured by Company through clinics or other institutions through which the physicians practice (each such institution, a "Physician Entity"). When an insurance policy is newly issued to a physician or Physician Entity, a single Class C share is deemed issued to each directly or indirectly insured physician; and if a Physician Entity adds a new physician, a new Class C share is deemed issued to such physician. No additional Class C shares are issued to a physician after the issuance of the initial share.

Although the Class C instruments are formally denominated as "shares," in substance they are more akin to membership interests in a mutual insurance company than to stock. These shares (which are not physically issued) may be owned only by a directly or indirectly insured physician, are non-transferable, are automatically redeemed and cancelled without consideration upon cancellation or non-renewal of the underlying insurance policy (or upon a physician's disaffiliation from an insured Physician Entity), and have no market value. The Class C shares confer rights to liquidating and non-liquidating distributions, but no distributions have been made to date (and none are anticipated, for distributions from the Parent Group generally take the form of dividends paid by Company to holders of its insurance policies (the "Policyholders")), and the sale or liquidation of Parent or Company is a remote contingency. Once the Class B share is redeemed, the Class C shares will confer voting rights as well.

As of Date A, there were b Class C Shareholders (each with one share), including c physicians who were Policyholders (the "Physician Policyholders") and d physicians who practiced through the Physician Entities. As of the same date, there were e Policyholders, of whom c (or f% of all Policyholders) were Physician Policyholders, g (or h%) were Physician Entities, and i (or j%) were non-physician entities (e.g., hospitals) that are not entitled to receive Class C shares (the "Non-Physician Entities"). Non-physicians (including the Physician Entities and Non-Physician Entities) are precluded

from owning Class C shares under Parent's Articles of Incorporation and By-laws, even though such shares are issued with respect to (and are inseparable from) the underlying insurance policies.

### **PROPOSED CONVERSION**

For what are represented to be valid business reasons, Parent plans to convert into a mutual insurance holding company under State A law in the manner described below (the "Proposed Conversion"). Each step of the Proposed Conversion will occur in accordance with and/or by operation of State A law.

1. Company will convert into a mutual insurance company. The conversion will result in (a) Parent transferring its ownership interests in Company to a mutual insurance holding company formed in step 2 below, and (b) Policyholders becoming members of Company.
2. Immediately after its conversion, Company will create a new State A mutual insurance holding company ("New Parent"). Upon the creation of New Parent, Company will be converted back into a stock insurance company as a wholly owned subsidiary of New Parent, and Policyholders will become members of New Parent.
3. Immediately after the formation of New Parent, Parent will merge with and into New Parent, with New Parent surviving. In the merger, the Class C shares of Parent will be cancelled.

The steps of the Proposed Conversion will occur (or will be deemed to occur pursuant to State A law) on the same day in the order described above, and each step will be contingent upon completion of each other step. All State A regulatory approvals will be contingent upon consummation of the entire Proposed Conversion.

Upon completion of the Proposed Conversion, New Parent will be the common parent of a consolidated group that includes Company, Sub 1, and Sub 2 (the "New Parent Group"), and all Policyholders will be members of New Parent. The Proposed Conversion will entail no change in Company insurance policies (e.g., no change in premiums, policy benefits or values, or other insurance obligations or benefits), and the membership interests in New Parent (the "New Parent Interests") will confer rights similar to those conferred by the Class C shares immediately prior to the Proposed Conversion.

### **REPRESENTATIONS**

The following representations have been made in connection with the Proposed Conversion:

- (a) None of the Class C shares to be transferred in the Proposed Conversion will be "§ 306 stock" within the meaning of § 306(c).
- (b) The only stock that will be exchanged in the Proposed Conversion will be the Class C shares, and the only ownership interests that will be issued by New Parent in the Proposed Conversion will be the New Parent Interests (all of which will be voting interests).
- (c) The Proposed Conversion will occur under a plan agreed upon before the Proposed Conversion.
- (d) The transfers and exchanges contemplated by the Proposed Conversion will occur on its effective date.
- (e) The fair market value of the New Parent Interests issued in the Proposed Conversion will be approximately equal to the fair market value of the outstanding Parent shares immediately before the Proposed Conversion.
- (f) The purpose of the Proposed Conversion is to facilitate the future growth of the Parent Group through partnerships and acquisitions so that it can increase its scale and geographic footprint. In this regard, the current capital structure of Parent as a stock company also having elements of a mutual company is confusing to potential partners and is a barrier to transactions, whereas a pure mutual holding company structure is an accepted capital structure in the insurance industry.
- (g) Immediately after the Proposed Conversion, the New Parent Group will continue in the same business (Business A) that the Parent Group conducted before the Proposed Conversion.
- (h) Immediately after the Proposed Conversion, the New Parent Group will continue to own substantially all of the assets and liabilities that were held by the Parent Group prior to the Proposed Conversion.
- (i) Each party will pay its own expenses, if any, incurred in connection with the Proposed Conversion.
- (j) The Proposed Conversion is not part of a plan to increase periodically the proportionate interest of any person in the assets or earnings and profits of Parent or New Parent.
- (k) No fractional shares or interests in Parent will be issued or exchanged in the Proposed Conversion.

- (l) Following the Proposed Conversion, New Parent will be treated under the laws of State A as a continuation of Parent.
- (m) At the time of the Proposed Conversion, Parent will not be under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

### **RULINGS**

Based solely on the information submitted and the representations set forth above, this office rules as follows:

- (1) For U.S. federal income tax purposes, the Proposed Conversion will be treated as if New Parent were a continuation of Parent, with Physician Policyholders, Physician Entities, and Non-Physician Entities constructively exchanging Parent shares for New Parent Interests.
- (2) The Proposed Conversion will be a reorganization within the meaning of § 368(a)(1)(E) (Rev. Rul. 2003-48, 2003-1 C.B. 863). Parent (and New Parent, as the continuation of Parent) will be a party to the reorganization within the meaning of §368(b).
- (3) No gain or loss will be recognized by New Parent in the Proposed Conversion (§1032(a)).
- (4) No gain or loss will be recognized by any of the Physician Policyholders, Physician Entities, or Non-Physician Entities in the Proposed Conversion (§354(a)(1)).
- (5) The basis of the New Parent Interests deemed received in the Proposed Conversion will equal the basis of the Parent shares deemed surrendered therefor (§358(a)(1)).
- (6) A New Parent member's holding period in its New Parent Interest deemed received in the Proposed Conversion will include the period such member held Parent stock (§1223(1)).

### **CAVEATS**

No opinion is expressed or implied about the tax treatment of the Proposed Conversion under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Conversion that are not specifically covered by the above rulings.

**PROCEDURAL MATTERS**

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

*Mark J. Weiss*

Mark J. Weiss  
Reviewing Attorney, Branch 1  
Office of Associate Chief Counsel (Corporate)

cc: